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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re

No. 00-44554 J13
Chapter 13

THOMAS BRIAN KELLY, JR. and
WENDELIN J. COLBY,

Debtors.

DECISION

Classified Flea Market, Inc. ("Classified") filed motions to dismiss this chapter 13 case, and for sanctions. Because the motion raised genuine issues of material fact, the court set the matter for trial pursuant to a Scheduling Order filed September 21, 2000. The matter having been tried, the court now renders its decision. Classified's motions will be denied.

On November 18, 1999, the California Superior Court entered a judgment against debtor Thomas Kelly ("Kelly") in the sum of \$161,29 This amount included an award of actual damages in the sum of \$11,05 punitive damages in the sum of \$22,102, attorneys' fees in the sum of \$120,550, and costs. The superior court also enjoined Kelly from soliciting Classified's customers for a period of 10 years. The

Decision

1 judgment is presently on appeal.

2 On July 31, 2000, the superior court ruled that an earnings
3 withholding order would issue against debtor Wendelin Colby ("Colby")
4 Three days later, on August 3, 2000, the debtors filed their joint
5 chapter 13 petition. Classified contends that they did not file the
6 petition in good faith, and that the court must therefore dismiss the
7 case. The parties agree that the absence of good faith on the part
8 the debtor is "cause" for dismissal pursuant to Bankruptcy Code §
9 1307(c). In re Eisen, 14 F.3d 469, 470 (9th Cir. 1994)¹.

10 Classified contends that numerous circumstances evidence the
11 debtors' lack of good faith. First, Classified contends that the
12 debtors intentionally undervalued their residence on Danbury Street
13 Oakland, California (the "Residence") in their bankruptcy schedules.
14 See In re Leavitt, 171 F.3d 1219, 1224 (9th Cir. 1999)
15 (misrepresentation of facts in a debtor's bankruptcy papers can be
16 evidence of bad faith). Specifically, Classified contends that the
17 debtors valued the Residence at \$250,000 when they knew or should have
18 known that the Residence was worth substantially more. In support of
19 its argument, Classified offered the expert testimony of appraiser R
20 Nissen, who testified that the fair market value of the Residence as
21 November 9, 2000 (approximately three months after the petition date
22 was \$350,000 and that debtor's scheduled figure of \$250,000 would not
23

24 ¹Indeed, the court may, in appropriate cases, dismiss the
25 petition with prejudice. In re Leavitt, 171 F.3d 1219, 1223-24 (9
26 Cir. 1999).

1 a reasonable estimate by any person who was "familiar with the market

2 The court rejects this argument for numerous reasons. Colby
3 testified that on July 16, 2000, prior to the filing, she obtained the
4 \$250,000 valuation figure by consulting "HomeGain", an Internet service
5 that provides estimates of the fair market values of residential
6 properties. (All one needs to do is type in the address and HomeGain
7 furnishes the value plus a description of the property.) Exhibit E,
8 copy of the valuation result Ms. Colby obtained, shows that on
9 July 16, 2000, HomeGain valued the property at \$230,442 - \$237,053.

10 Colby further testified that in July of 2000, she consulted real
11 estate listings in the San Leandro Times newspaper, and found that the
12 median price of homes in San Leandro (some quarter mile from the
13 Residence) was \$240,000. See Exhibit H. The foregoing items establish
14 that independent of what valuation might result from appraisal testimony
15 concerning the Residence, the debtors did not intentionally undervalue
16 it in their bankruptcy schedules, but rather, researched the issue and
17 provided what appeared to them to be an accurate and good faith
18 estimate.

19 Classified argues that the debtors knew or should have known that
20 the valuation provided by HomeGain was too low because HomeGain referred
21 to sales of comparable properties that were from 1998, not 1999. That
22 argument assumes a sophistication in real estate analysis, and knowledge
23 of the details of recent home sales, on the part of the debtors that
24 they did not have. Classified makes no allegation that the other
25 information concerning the Residence that HomeGain took into account

1 disclosed in its valuation, was inaccurate, or that any other red fl
2 were present that might have shown the debtors that HomeGain was wro
3 Thus, whether or not the comparables reported by HomeGain were up-to
4 date, the court is satisfied that the debtors estimated the value of
5 Residence in good faith.

6 This conclusion is supported by the expert testimony of apprais
7 Richard Yoon, who appraised the residence and testified that as of
8 September 25, 2000, it had a fair market value of \$250,000 (see Exhi
9 B). While it might be debated which appraisal - Mr. Nissen's or Mr
10 Yoon's - is the more accurate², the ultimate issue here is bad faith
11 the evidence simply did not support Classified's contention that the
12 debtors intentionally undervalued their residence.

13 Classified next argues that debtors filed their chapter 13 case
14 merely to discharge debt that would be nondischargeable in a chapter
15 case. Although Classified's judgment against the debtors is not fin
16 this court ruled prior to trial that, based on the superior court's
17 findings, it would for present purposes assume that the debt would b
18 nondischargeable in a chapter 7 case. See Scheduling Order, paragra
19 11.

20 The parties agree that the mere fact that a chapter 13 debtor s
21

22 ²The difference seems to stem from their selection of differer
23 properties as "comparables". On balance, the comparables used by
24 Nissen appear to the court to be the more reliable, because they w
25 in the same neighborhood as the subject property, and more closely
26 resembled the subject property in square footage. It does not
follow, however, that Mr. Yoon's valuation was not a reasonable on

1 to discharge debts in chapter 13 that would not be dischargeable in
2 chapter 7 case does not mean that the debtor did not file the petiti
3 in good faith. Rather, the court must consider the totality of the
4 circumstances. In re Warren, 89 B.R. 87 (9th Cir. BAP 1988).

5 In Warren, id. at 95, the BAP stated that Congress provided for
6 "super discharge" in chapter 13 to provide debtors with an incentive
7 commit to and perform a repayment plan, and that the court should no
8 "neutralize" that incentive by confirming chapter 13 plans that are
9 effect "veiled chapter 7 cases." Thus, if the debtors were proposin
10 pay a minimum amount, or make payments for a minimum period, this wo
11 be a circumstance that would weigh against them.

12 But that is not the case here. Debtors' amended plan proposes
13 pay \$87,300 to unsecured claimants over a period of 60 months, more
14 what they might reasonably expect to receive in a chapter
15 7 case, at least from the proceeds of the residence³. Moreover, with

17 ³The residence is subject to a lien in the approximate sum of
18 \$181,000 and the debtors are entitled to a homestead exemption in
19 sum of \$75,000. Thus, assuming no other nonexempt assets, a
20 hypothetical sale of the residence in a chapter 7 case would have
21 yield a net amount after costs of sale and commissions of over
22 \$343,300 (\$181,000 + \$75,000 + \$87,300 (plan offer to unsecured
23 claimants) in order for the unsecured claimants to be better off i
24 chapter 7 case. Based on the appraisal testimony described above,
25 the court finds that \$87,300 exceeds the amount that the unsecured
26 claimants would realize from the Residence if it were sold by a
chapter 7 trustee.

For example, if the court were to value the residence at
\$315,000 as of the petition date, a conclusion amply supported by
(continued...)

1 three young children (ages 3, 5, and 15 mos. as of the date of the
2 petition) to feed, and Colby's salary, the primary source of the fam
3 income, about to be levied on, chapter 13 relief cannot be viewed as
4 per se unreasonable option for the debtors, especially when their pl
5 proposes to pay unsecured claimants a meaningful dividend⁴.

6 Classified's next contention is that the debtors misrepresented
7 amount of their child care expense. The evidence, however, showed t
8 the debtors accurately scheduled this expense. Classified also clai
9 that the expense is unreasonable because until recently, Kelly's mon
10 earnings of \$400 as a cartoonist (working out of the home) were less
11 than the debtors' monthly child care expense of \$1,100. Kelly testi
12 that he needed to stay in practice if he was to increase his income,
13 that he could not both work and care for the children without child
14 assistance. Recently, Kelly obtained an additional client that will
15 increase his monthly income by \$1,000, perhaps showing that his stra
16 has worked. In any event, the court finds that the debtors' schedul
17 and incurring of the indicated child care expense was not in bad fai
18

19 ³(...continued)
20 evidence herein, then a sale would produce a net of roughly \$34,00
21 less the chapter 7 trustee's fees, for the unsecured claimants, if
22 broker's commission of 6% (\$18,900) plus the termite work and othe
23 costs of sale totaled \$25,000. (\$315,000 - \$181,000 (deed of trus
- \$75,000 (homestead) - \$25,000 (commission plus costs) = \$34,000.

24 ⁴The scheduled unsecured claims total \$233,103. Dividing
25 \$87,300 by this amount produces a dividend of \$.37 on the dollar,
26 although the actual dividend will be less because of the additiona
counsel fees the debtors' counsel anticipates requesting.

1 Classified's next contention is that the debtors improperly fun
2 an IRA to remove the funds from the jeopardy of a levy by Classified
3 Debtors disagree and argue that the funds were in an exempt pension
4 account before they funded the IRA, and in any event, that the fundi
5 of the IRA was not wrongful.

6 At the trial herein, the court declined to hear evidence on thi
7 issue. Although Classified questioned the validity of the debtors'
8 exemption in its motion to dismiss, it had not filed any formal
9 objection to the exemption as of the date of the status conference
10 herein⁵. In the interest of judicial economy, and to assure that the
11 parties knew which issues would be tried, the court ordered in its
12 Scheduling Order filed September 21, 2000 that the validity of the I
13 exemption would be at issue at trial only if Classified subsequently
14 filed a timely objection. As of the trial date, Classified had not
15 filed any objection.

16 Classified contends that the debtors improperly transferred \$20
17 to Haight, Brown, and Bonesteel ("Haight"), a law firm of which Kell
18 brother is an associate, and that this transfer was an "insider
19 preference" avoidable under Bankruptcy Code § 547(b) (and at a minim
20 must be accounted for in any comparison of this chapter 13 case with
21 hypothetical chapter 7). Debtors contend that they paid this amount
22 Haight as its fee for representation in the pending appeal, and thus
23 that it was not preferential.

24 _____
25 ⁵Generally, debtors may appropriately claim IRAs as exempt. Ir
26 re McKown, 203 F.3d 1188 (9th Cir. 2000).

1 Neither party introduced any documents into evidence. The only
2 evidence presented was the testimony of Kelly and Colby, which was
3 uncontroverted⁶. For present purposes only, the court finds that the
4 transfer of the \$20,000 to Haight was neither fraudulent nor
5 preferential.

6 Classified makes a number of other arguments that do warrant
7 discussion, and the court rejects them⁷. The court has considered
8 the issues raised by Classified and other relevant factors, and
9 concludes that the debtors have met their burden of establishing good
10 faith. Warren, 89 B.R. at 93.

11 One final issue remains, and that is the status of the debtors'
12 amended chapter 13 plan. The court does not know whether the chapter
13

14 ⁶Classified argued that Haight filed a late reply brief in the
15 appellate proceedings, and invites this court to conclude from this
16 allegation that the \$20,000 was not paid to Haight for its appellate
services. The court declines to do so.

17 ⁷One such argument is that the debtors could pay Classified in
18 full if they liquidated all their property, including the Residence
and their exempt retirement accounts, and paid the funds over to
19 Classified, and that the court may order them to do so (citing
20 Cal.Civ.Pro. Code § 703.070 regarding child support obligations).
Another is that Kelly secretly intends to go back into the rack
21 business and thereby enhance his income, and perhaps unfairly compete
with Classified, after this chapter 13 case has been concluded.
22 These arguments are without legal or factual basis. The court does
23 note, however, that if, at any time during the 60 month plan period
the debtors' disposable income increases, the trustee or any
24 unsecured claimant may move to modify the plan. See Bankruptcy Code
25 § 1329(a)(1); In re Powers, 202 B.R. 618, 622-23 (9th Cir. BAP 1999).

1 trustee is aware of the recent increase in Kelly's income, and if no
2 whether the trustee objects to, or recommends, confirmation.
3 Consequently, the court requests the chapter 13 trustee to file and
4 serve upon debtors and Classified, a statement of her position
5 concerning confirmation of the chapter 13 plan. Debtors shall coope
6 by providing the trustee with any information she may request.

7 Dated: December 18, 2000

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10 Edward D. Jellen
United States Bankruptcy Judge